Epping Senior Housing Associates LP

v.

Town of Epping

Docket Nos.: 19135-01PT/19855-02PT/20263-03PT

ORDER

I. Introduction

The board consolidated these appeals for three tax years involving the same "Taxpayer" and "Town" for a limited hearing on the specific legal issue described in Section II below. The hearing was held on January 19, 2005, following a Prehearing Conference held on September 22, 2004.

As set forth in the Prehearing Conference Order issued on October 5, 2004, the parties agreed to submit an agreed statement of facts and memoranda of law by November 17 and December 17, 2004, respectively, in preparation for the limited hearing. The board has relied on the submitted "Agreed Statement of Facts" (Taxpayer Exhibit 1) and the memoranda submitted by the attorneys for the Taxpayer and the Town, as well as the joint exhibits (identified in "The Parties' List of Exhibits" and set forth in Taxpayer Exhibit 2). The board also considered the additional exhibits, testimony and arguments presented at the limited hearing, including the testimony of John Viele, the Housing Development Director of Rockingham Community Action, John Anton, President of Northern New England Housing Investment Fund, Morton Blumenthal,

an appraiser for the Taxpayer; and Joseph Lessard and Scott Marsh of MRI, the contract assessors for the Town.

As in all tax appeals, the Taxpayer has the burden of proof. In order to prevail, the Taxpayer must establish that the Town disproportionately assessed the Property. See RSA 76:16-a; TAX 201.27(f); TAX 203.09(a); Appeal of City of Nashua, 138 N.H. 261, 265 (1994).

II. Legal Issue Presented

The legal issue submitted for decision by the board is whether the Town could properly consider the value of Low Income Housing Tax Credits ("LIHTC's") (a federal investment tax credit program to stimulate the construction of affordable housing, created by Section 42 of the Internal Revenue Code of 1986) in assessing the "Property" owned by the Taxpayer. For the reasons indicated below, the board rules the Town can and should consider the value of the LIHTC's associated with the Property in fulfilling its obligation to make proportional assessments.

The board recognizes the importance of this issue, both to the parties in these appeals and to other municipalities and taxpayers, and that it appears to be one of first impression in New Hampshire. In deciding the issue, the board has relied on the key facts summarized below, its own review of New Hampshire law and additional case authorities considering LIHTC's in other jurisdictions cited by the parties.

III. Summary of Key Facts

The following summary is based upon the Agreed Statement of Facts and is not in dispute.

The Property consists of a 20-unit apartment complex known as "Whispering Pines II," which serves low income elderly tenants in a two-story building on five acres of land; the rental

housing consists of 16 one-bedroom and four two-bedroom units, which were constructed and fully occupied by October, 2001.

The parties further stipulated the conventional real estate market would not provide funding to construct low income elderly housing and that a serious lack of affordable housing now exists. The Taxpayer was formed by Rockingham Community Action (the "Developer"), a non-profit organization. The Taxpayer is a (for profit) limited partnership created to address the "serious lack of affordable housing . . . for senior citizens."

The structure of the limited partnership consists of one general partner and one limited partner, designated as the "Equity Investor."[1] The Equity Investor consists of one general partner[2] and five limited partners who are financial institutions (Bank of New Hampshire, Citizens Bank of New Hampshire, Fleet Bank, Key Community Development Corporation and Providian Bancorp Services). These five financial institutions contributed approximately $1.89 million for 99.99% of the ownership interest in the Equity Investor and the right to receive 99.99% of the Property's LIHTC's.

In essence, the LIHTC program encourages private investment in the construction of affordable housing by reducing the income tax liability of the owners of the Property and does so, unlike other federal subsidy programs, without any rental or operating expense subsidies; instead, all operating expenses must be paid from rental income and any applicable reserves. LIHTC's provide dollar-for-dollar credits against the federal income tax liability of investors over a ten year period. Congress establishes the total pool of tax credits which are then allocated to individual states, who actually administer the LIHTC program. Here, the credits are

[1] The general partner is Rockingham County Housing, Inc., a subsidiary of the Developer. The "Equity Investor" is New Hampshire Housing Equity Fund 1999 Limited Partnership.

[2] The general partner of the Equity Investor is Northern New England Housing Equity Fund, Inc., a subsidiary of a non-profit organization (Northern New England Housing Investment Fund) who "acts on behalf of the limited partner [the Equity Investor]."

administered and allocated by the New Hampshire Housing Finance Authority ("NHHFA"), which in this case allocated $232,223 annually for a period of ten years, or a total of $2,322,230, as the LIHTC's for the Property, a sum that slightly exceeds the "[a]ctual total costs" ($2,321,476), of the Project, including "construction costs, syndication costs, developers' fees and project reserves."

A development is not eligible for LIHTC's unless it complies with a number of detailed conditions and restrictions, as well as ongoing monitoring and regulation by the NHFFA, with restrictions in place for a term of 30 years. To be eligible for the LIHTC program, each project must meet certain tenant income and rent criteria. In 2003, for example, tenants at the Property had average annual incomes of $16,400. The rent restrictions, in turn, result in rents that are lower than the market rents an unrestricted apartment project would charge for equivalent housing.[3] The net effect of these restrictions is to reduce the rental revenue stream the Property will generate while it remains in the LIHTC program.

IV. Board's Rulings

The parties candidly acknowledge that "there are no New Hampshire cases specifically addressing the effects of tax credits on the valuation of property for tax assessment purposes" and that it is "a matter of first impression." See Town's Memorandum at p. 5 and Taxpayer Memorandum at p. 5. Consequently, the board has been asked to issue a legal ruling for the guidance of the parties.

The board finds the LIHTC's can and should be considered by the Town in making ad valorem assessments on the Property under New Hampshire law. The issue is not whether such tax treatment may be questionable social policy [arguably retarding, rather than

[3] From the testimony at the hearing, the board notes the parties may disagree about the magnitude of difference between market rents and actual rents, a factual issue that need not be decided here.

encouraging, the development of affordable housing by the private (for profit) investment market because of higher annual property tax obligations]. As further noted below, the "Legislature," rather than the board, is the proper forum for resolving such issues. Rather, the board finds the Taxpayer simply has not met its burden of proving the Town is acting contrary to present law by considering the value of the LIHTC's in its assessments, a practice also consistent with the majority of other jurisdictions that have examined their treatment for property tax purposes.

As stated in the Town's Memorandum at pp. 3-4, the supreme court has identified three constitutional provisions that insure taxation is "just, uniform, equal, and proportional." See Smith v. New Hampshire Dept. of Revenue Admin., 141 N.H. 681, 685-86 (1997) (citations omitted). Part I, Article 12 of the New Hampshire Constitution requires "[e]very member of the community . . . . to contribute his share" of the expense of government. Part II, Article 5 authorizes the Legislature "to impose and levy proportional and reasonable assessments, rates, and taxes." Part II, Article 6 permits the Legislature to distinguish "classes of property" for taxation purposes.

With respect to the constitutional authorization for "classes of property," the Legislature has done so, for example, with respect to property qualifying for exemption under RSA 72:23, et seq. and for current use under RSA Ch. 79-A, but no analogous statutory provisions exist for property built by a for profit entity to promote affordable housing, such as the Property in this case. Cf. The Housing Partnership v. Town of Rollinsford, 141 N.H. 239, 240 (1996) (reversing property tax exemption granted to nonprofit corporation devoted to providing '"decent, safe, and affordable housing for low and moderate income persons'" where it failed to meet statutory requirements for an exemption).

Consistent with this broad taxing authority under the Constitution, RSA 72:6 prescribes that "[a]ll real estate, whether improved or unimproved, shall be taxed except as otherwise

provided." RSA 21:21, I further provides: "[t]he words 'land,' 'lands' or 'real estate' shall include lands, tenements, and hereditaments, and all rights thereto and interests therein." (Emphasis added.) Property is therefore commonly referred to as involving ownership of various "sticks" in a bundle of rights. Cf. Opinion of the Justices (Public Use of Coastal Beaches), 139 N.H. 82, 94 (1994).

It should be noted that, unlike the laws in some states mentioned in the Taxpayer's Memorandum (see footnote 6 infra), the New Hampshire tax statutes do not distinguish between property rights that are "tangible" and those that are "intangible" in nature. In Verizon New England v. City of Rochester, 151 N.H. 263, 268 (2004), for example, the supreme court recently rejected an argument that a utility "has only an intangible right to use the public ways" in a municipality and therefore could not be "subject to the assessment of real estate taxes."

So long as the specific rights ('sticks in the bundle') are inseparable from real estate ("an interest therein"), they are subject to ad valorem property taxation. Thus, for example, factors as disparate as favorable zoning (another type of government restriction) or below-market interest financing (another type of investor incentive or inducement) can increase the market value of real estate and therefore its assessment.

In this regard, the Taxpayer's reliance on Appeal of Town of Plymouth, 125 N.H. 141 (1984) is misplaced. While that case did decide that certain personal property (ski passes, furnishings, etc.) could not be assessed, the court made this ruling because it could not find that such items were "'intimately intertwined' with the primary use of the condominium property." Id. at 145. The Plymouth court cited King Ridge, Inc. v. Town of Sutton, 115 N.H. 294, 299 (1975) (ski lifts "intimately intertwined" with land used as winter ski area and taxable under RSA 72:6) and suggested "specialized intrinsic features" could be taxed. 125 N.H. at 145.

Accord, Crown Paper Co. v. City of Berlin, 142 N.H. 563, 569 (1997) (remanding issue to trial court):

> The meaning of the term "intimately intertwined" is well established. (Citations omitted.) For a piece of factory machinery to be intimately intertwined with the underlying realty and thus taxable, the trial court must determine that some characteristic of the underlying realty makes a special or other use of the factory machinery useful, and that the special or other use of the factory machinery renders the underlying realty useful. (Citations omitted.)

While the Taxpayer is correct that LIHTC's confer benefits on the individual owners of the Property (by reducing federal income tax liability), the board finds the benefits are directly tied to ("intimately intertwined" with) the Property, cannot be separated from the Property and serve to make the Property more "useful" (valuable) in the real estate market. In other words, the tax benefits, by their nature, transfer when the Property is sold, along with other sticks in the bundle of rights and add value. An argument based on the 'limited market' for properties conferring LIHTC benefits and that the benefits will expire (amortize) over a fixed period (10 years) goes to the issue of how much value they embody in any given tax year, not whether they add value and are therefore subject to taxation at all.

Unless excepted as noted above, RSA 75:1 requires the Town to "appraise all taxable property at its full and true value in money as they would appraise the same in payment of a just debt due from a solvent debtor, and shall receive and consider all evidence that may be submitted to them relative to the value of property . . . ." This formulation is commonly referred to as "market value." See Appeal of Town of Newmarket, 140 N.H. 279, 285 (1995).

When addressing market value, it is, of course, "transmissible value," not "worth to the owner alone" that is the proper focus. 590 Realty Co. Ltd. v. City of Keene, 122 N.H. 284, 286-87 (1982). Any "specialized features," such as, for example, "special architectural features and

equipment" in a building (other than personal property, of course), must be considered in a tax system based on the market value of real estate. Id.

A related requirement is that property must be assessed at its "highest and best use," id. at 285, which means the "use which will most likely produce the highest market value, greatest financial return, or the most profit." Steele v. Town of Allenstown, 124 N.H. 487, 490 (1984) (quotation marks and citation omitted). The LIHTC's at issue herein clearly have substantial value (approximately $2.32 million over ten years, as noted above) and the board finds no evidence they would not be transmissible to subsequent owners if the Property is transferred. Indeed, given the lower than market rents allegedly generated by the Property and the further restrictions imposed because of the LIHTC program, it would be unrealistic to assume a potential buyer would consider only the burdens, and not the benefits, associated with the Property.

The Property is restricted both in terms of who is eligible to be a tenant and how much rent can be charged. A potential buyer would take these negative aspects into account, but would balance them against the positive aspects, including available tax credits under the LIHTC program. According to the testimony, potential buyers include financial institutions capable of utilizing the tax credits and other features of the Property. While this market may not be as large or as wide as for other property, the Taxpayer failed to demonstrate that it was nonexistent or unimportant.[4]

Since there is no dispute that continued operation of the Property in the LIHTC program appears to be its highest and best use, the benefit of tax credits should be taken into account. To look at only the limitations of ownership (such as lower rental income), but not the tax credits,

[4] According to the Taxpayer's witness, John Anton, potential buyers are attracted to invest because the substantial after-tax yield (currently "+/- 7 %") is augmented by the LIHTC's, which confer "[u]nlimited use of federal tax credits," and by the "[n]o passive loss restrictions" feature, as well as by "Community Reinvestment Act" incentives for financial institutions to make certain types of investment. These desirable incentives exist even without consideration of any additional benefits from cash flow or the residual value of the assets. See Taxpayer Exhibit 3.

would be to look at only a part of, rather than the whole of, the full picture that determines the market value of the Property for assessment purposes.

This approach is consistent with prior New Hampshire cases. In Steele, for example, the court held the benefits of participation in a federally subsidized housing program should be taken into consideration in determining the assessment, even though such participation imposed some restrictions on the transferability of the property. Id. at 490-91. The court noted that although the government subsidized contract was "personal to the plaintiffs," the property could have been sold and the benefits "available to others for such use. '[A]ll uses of which the property inherently and in its own character are capable serve in the reflection of value.'" Id. (quoting from Trustees &c. Academy v. Town of Exeter, 92 N.H. 473, 486 (1943)). In Steele, as here, "the property was designed and constructed as a federally subsidized housing project. It has operated as such, and we find nothing in the record which indicates that it will not continue to so operate." 124 N.H. at 491.

In Royal Gardens Co. v. City of Concord, 114 N.H. 668, 670-72 (1974), the court ruled that it was error for a master, for tax assessment purposes, not to consider the twin effects of federal regulation and subsidy in a housing project which limited rental income, but also provided long-term financing below market interest rates. As the court noted, government regulation is a "factor . . . relevant for valuation purposes," because "[g]enerally, the rule as to what bears on value has always allowed the admission of all relevant and nonprejudicial evidence." Id. at 671 (Citation omitted).

The board finds a significant similarity exists, for tax assessment purposes at least, between regulatory programs that provide low interest financing directly (as in Royal Gardens) and programs that encourage (through investment tax credit incentives inherent in the LIHTC program) more equity financing by investors to substitute for conventional financing. In both

instances, government subsidy is needed because the actual rents that can be charged will not allow the private financial markets to make the real estate investment on their own.

The conclusion reached by the board that LIHTC's should be considered for property tax assessment purposes is consistent with the majority of the courts that have considered this issue. As noted in the Town's Memorandum at pp. 5-7, states adopting the majority view include Tennessee, Illinois, Georgia, Pennsylvania, Idaho, Kansas and Connecticut.[5] The board finds the detailed analysis of the LIHTC program and the review of cases from other jurisdiction by the Tennessee Court of Appeals in Spring Hill, L.P. v. Tennessee Board of Equalization, 2003 Tenn. App. LEXIS 952 (December 31, 2003), to be especially helpful and persuasive, as well as being the most recent relevant decision cited by the parties.

> In Spring Hill, a witness explained the operation of an LIHTC program, as follows:
>
> The owner contracted with the Tennessee Housing Development Agency [Tennessee's equivalent to NHHFA] to receive tax credits for a ten-year period for the subject properties. By contract he gave up some of his property rights in order to receive this benefit. These were:
>
> - the right to lease the property to whoever he pleases and for the amount he wishes;
> - the right to sell without restraint;
> - the right to use the property without restraint.
>
> Therefore, in order to properly appraise the subject's fee simple interest, the full bundle of rights, the present worth of the tax credits must be added to the income value for this is payment for relinquishing the rights listed above.

Id. at p. 12 of Decision (no further pagination in LEXIS). The court agreed with the taxing authority by concluding that "it is appropriate to include all interests in the real property in

[5] In addition to the Tennessee Spring Hill decision, cited above, see Rainbow Apartments v. Illinois Property Tax Appeals Bd., 762 N.E.2d 534 (Ill. App. 2001), citing Kankakee County Board of Review v. Property Tax Appeal Bd., 544 N.E.2d 762, 768-70 (Ill. 1989); Pine Point Housing, L.P. v. Lowndes County Bd. of Tax Assessors, 561 S.E.2d 860 (Ga. Ct. App. 2002); Parkside Townhomes Assoc. v. Bd. of Assessment Appeals of York Co., 711 A.2d 607 (Pa. Commw. Ct. 1997); Greenfield Village Apts. v. Ada County, 938 P.2d 1245 (Idaho 1997); In re Ottawa Housing Assoc., L.P., 10 P.3d 777 (Kan. Ct. App. 2000); and Deerfield 95 Investor Assoc., LLC v. Town of East Lyme, 1999 Conn. Super. LEXIS 1747 (Conn. Super. Ct. 1999).

assessing its value and to consider value- enhancing as well as value-reducing factors." Id. at p. 22. The court affirmed a valuation methodology that took into account both the "positive" or "value-enhancing effect" of the LIHTC's and the "value-reducing effect of the restricted rents received." Id. at p. 9. In Spring Hill, the appraisal methodology calculated and included in the assessment "the present value of the Tax Credits." Id. at p. 11.

As Spring Hill and the courts in the majority of jurisdictions have found, LIHTC's, whether or not they are regarded as "intangible" interests, nonetheless 'run with the land' and affect the market value of the real property; they are tied to the real property itself and cannot be dismissed simply as being 'personal to the owner': instead, "[t]he Tax Credits are irrevocably attached to the real property." Id. at p. 48.

In comparison, the board finds the contrary authorities from fewer jurisdictions (Arizona, Washington, Missouri and Oregon), cited in the Taxpayer's Memorandum at pp. 9 – 11, to be both less persuasive and more distinguishable. As noted by the Tennessee court (in Spring Hill, footnote 22), these decisions generally relied on state laws that circumscribed the real property taxation of intangibles, often because such interests were found to be personal property rather than real property.[6] Nor is the Taxpayer's reliance on Randall v. Loftsgarden, 478 U.S. 647 (1986) helpful. Randall holds that tax credits "have no value in themselves" and therefore their receipt "is not itself a taxable event" for federal income tax purposes. Id. at 656-57. As noted by

[6] See Cottonwood Affordable Housing v. Yavapai Co., 72 P.3d 357 (Ariz. 2003) [citing prior Arizona case law, Arizona Tractor Co. v. Arizona State Tax Comm., 566 P.2d 1348, 1350 (Ariz. Ct. App. 1977) to effect that a real estate partner's interest is '"intangible personal property'"]; Cascade Court Ltd. v. Noble, 20 P.3d 997, 1002 (Wash. Ct. App. 2001) (tax credits are intangible personal property not subject to real property taxation under Washington statutes); Maryville Properties, L.P. v. Nelson, 83 S.W.3d 608, 612-13 and 617 (Mo. Ct. App. 2002) (Missouri Constitution prohibits inclusion of intangible personal property in real property values; LIHTC's are "intangible property. There is no statutory authority for the consideration of these tax credits in real estate tax appraisal in Missouri."); and Bayridge Assoc. Ltd. v. Dept. of Revenue, 892 P.2d 1002, 1003 (Or. 1995) (statute regulated taxation of property subject to '"governmental restrictions as to use'"). As noted above, the board disagrees with the conclusion that LIHTC's are intangible personal property. An additional difficulty with the Cottonwood case, chiefly relied upon by the Taxpayer, is that it contains no discussion of contrary authority regarding LIHTC's from the majority jurisdictions mentioned above.

at least one of the majority jurisdictions finding the value of LIHTC's to be taxable for property tax purposes, this holding in Randall "does not mean that the tax credits do not influence a property's fair market value, which is the issue here." Pine Pointe, 561 S.E.2d at 865.

The board has also reviewed the secondary authorities cited by the Taxpayer.[7] While they are of some professional interest to the appraisal community, they do not require a different outcome regarding whether LIHTC's should be considered in the assessment of the Property. The USPAP Advisory Opinion 14 (Exhibit C in the Taxpayer's submittal filed on January 10, 2005), for example, may suggest the value of subsidies and incentives should be separately stated in the appraisal report, but this does not require their exclusion in a property tax assessment. The USPAP recommendations also contain the customary express qualifications regarding the possible effect of local laws and the USPAP analysis does not represent "the only possible solution to the problems discussed."

The parties acknowledge that a legislative solution is feasible on the issue addressed and, in fact, has already been implemented in some states. See Town Memorandum at p.11; and Taxpayer Memorandum at p. 16. Unless and until the New Hampshire Legislature considers and enacts legislation applicable to LIHTC's, however, the board must rule based upon its own interpretation of existing law. As noted above, including the relevance and application of RSA 75:1, RSA 72:6 and RSA 21:21, I, the board finds merit in the Town's position that the value of LIHTC's can be considered in fulfilling the Town's obligation to make a proportional assessment of the Property.

[7] The Polton articles, for example, from the Appraisal Journal (Exhibits A and D in Taxpayer's Submittal filed on January 10, 2005) recommends analyzing the tangible and intangible values of properties subject to the LIHTC separately, and refers to the USPAP Advisory Opinion discussed infra, but acknowledges "there is no consensus yet in the assessment community."

V. Further Proceedings

The board hopes this Order will be of benefit to the parties in their further discussions and possible agreement on the remaining valuation issues. As noted in the Prehearing Conference Order at p. 2, if such discussions are unfruitful, the board will proceed to schedule a hearing on the proper valuation of the LIHTC's in each tax year.

In the alternative, as the parties' attorneys are no doubt aware, RSA 541:3 and 541:6 provide a statutory mechanism to appeal an order of the board, even one made prior to the valuation hearing and entry of any final decision in these appeals. See also TAX 201.37 for the relevant procedures; the operative date for the requisite motion is the clerk's date below, not the date this Order is received. Id.

SO ORDERED.

BOARD OF TAX AND LAND APPEALS

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Paul B. Franklin, Chairman

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Michele E. LeBrun, Member

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Albert F. Shamash, Esq., Member

Certification

I hereby certify that copies of the foregoing prehearing conference order have this date been mailed, postage prepaid, to: Margaret H. Nelson, Esq., Sulloway & Hollis, P.L.L.C., Post Office Box 1256, Concord, New Hampshire 03302, counsel for the Taxpayer; John J. Ratigan, Esq., Donahue, Tucker & Ciandella, 225 Water Street, Exeter, New Hampshire 03833, counsel for the Town; Chairman, Board of Selectmen, 157 Main Street, Epping, New Hampshire 03042; and Mark Lutter, Northeast Property Tax Consultants, 37 Crystal Avenue – PMB 290, Derry, New Hampshire 03038, Interested Party.

Date: March 18, 2005

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Anne M. Stelmach, Deputy Clerk